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SUBJECT: THROUGH DISCOUNT CHAIN, THE STATE TAKES OVER MUCH
OF FOOD DISTRIBUTION

Classified By: Economic Counselor Richard M. Sanders. Reason: 1.4(b)
and (d).

Summary

1. (C) The state-owned "Mercal" chain of discount food stores may be for lowest income Venezuelans the most visible sign of the Bolivarian revolution. Paid for with petroleum revenue, it has become a massive undertaking, with thousands of outlets, either state-run or franchised, that provide staples at up to 30 pct below regular prices, along with a modest dose of propaganda. As a result, it is squeezing the private sector out of a large part of the retail food sector, although businesses are trying to recapture market share. While the military services had the initial responsibility in organizing the Mercal chain's logistics, their role has diminished as civilian managers, some from the food industry, take their place. Cuban experts are also present in advising Mercal management. Mercal buys much of its food from private suppliers, but the GOV wants to increase the direct state presence in food production. Although Mercal's organizational capabilities have become impressive, state subsidies are required for it to maintain the heavy discounts which make it so popular; it is thus highly dependent on continued high oil revenues. Nonetheless, the Mercal success story shows that the GOV commitment to return the state to the lead role throughout the economy is real, not just rhetorical. End summary.

A Store For Everyman

2. (C) On February 18, econcouns and agcouns met with Imelda Cisneros, President of the Venezuelan office of multinational consulting firm Arthur D. Little, and Jurgis Vitols, one of the firm's consultants. They provided a detailed briefing on the current status of the GOV's Mercal discount food chain, based on a study which the firm had done for several food sector clients. Mercal ("Mercados de Alimentos" -- food markets) was initially set up as a successor to the various outdoor "mega-markets" which the GOV had set up in late-2002 along key routes into central Caracas (principally as a means of blocking any protest marches from using those routes). During and immediately after the December 2002-February 2003 general strike, such markets were also used as a means to ensure food deliveries. The Mercal chain was set up afterwards with the evident aim of ensuring that the state would maintain a key role in controlling food supply to low income Venezuelans in the face of any further political unrest.

3. (C) While the Mercal chain initially appeared to be somewhat of a token gesture, with only a few convenience store-sized outlets, it grew rapidly throughout 2003 and 2004. It has also acquired a permanent institutional home, in a new "Ministry of Food," together with CASA, the GOV's wholesale food purchasing arm. Mercal's extensive network together with a policy of selling at a deep discount have made it one of the GOV's most popular programs, one which had a significant role in the recovery in President Hugo Chavez's popularity which allowed him to defeat a recall referendum on August 15, 2004. The Arthur D. Little study characterizes the different kinds of stores now maintained by Mercal as follows:

-- Mercals (Type 1): These are the original Mercal stores, owned and operated by the state, with staple goods only, sold at discount prices. Mercal's website lists 172 such stores.

-- Mercals (Type 2): These may be either state-owned or owned by a private individual using the Mercal franchise. In addition to the staples, they may have some other products, sold at commercial prices. (Information as to

number of stores is unavailable on Mercal's website; GOV spokesmen have given estimates ranging from 250 to 750 such stores.)

-- Supermercals: These are larger stores, operated by

franchisers, usually on the premises of a former small supermarket which had gone out of business. Arthur D. Little consultants had visited one in the western Caracas neighborhood of Propatria, which they found well patronized. The Mercal website lists 17 such stores.

-- Mercalitos: Mercal has mounted small stores, in effect taking over small "bodega" corner stores to distribute its basic products. (In many cases the sales are actually run from an individual's house.) In September 2004, Chavez announced that there were 6,423 Mercalito outlets.

-- Truck Delivery: In rural districts Mercal distributes its products to customers via truck.

Closely related, although organizationally distinct from Mercal is the GOV's PROAL ("Programa de Alimentacion") feeding program), which mounts soup kitchens which provide free meals for the poorest of the poor and also provides bags of basic commodities which can be cooked at home.

----- Rock Bottom Prices -----

14. (C) The Arthur D. Little study determined, based on surveying the prices at the stores, that for the basic staples such as powdered milk, rice, canned sardines, etc. which are common to all Mercals, prices are a remarkable 30 pct below the official controlled price above which it is illegal to sell them. By contrast, privately owned stores, which directly compete with Mercal, charge an average of 15 pct below the controlled price. Mercal has some inherent advantages, e.g. it does not rely at all on paid advertising, and many of its stores, particularly the larger Supermercals, were given to it by the GOV, which had received them from failed banks. Nonetheless, so deep a discount can only be obtained through heavy subsidization of Mercal operations. In addition to directly funding Mercal's purchases, another way in which the GOV supports is by allowing imports for Mercal to enter Venezuela duty-free.

----- Some Propaganda with Your Food -----

15. (C) While some Mercal items are sold directly in packaging from the suppliers from which they were obtained, staples typically are re-bagged in packages which state that they are provided by the "Bolivarian Government" and identifying them as produced by state food purchasing agency CASA. CASA in effect acts as a "private label" for Mercal. CASA bags have a standardized format, which includes a direct political message - usually a quotation from the Bolivarian constitution, and accompanying illustration, e.g. a bag of rice with the text of a constitutional article regarding respect for multi-culturalism, and an picture of smiling black and indigenous Venezuelans. Mercal workers often wear red (the color of the revolution) t-shirts. However, overt political agitation seems to be largely absent from Mercal stores.

----- Army Less Present, Cubans Still There -----

16. (C) Initially, the Venezuelan military were deeply engaged in Mercal as successor to the military-run mega-markets; they provided the transportation capabilities and organizational skills necessary to get this new entity up and running. (There were constant reports of massive corruption on the part of the military officers involved in Mercal.) While the leadership of Mercal and the Ministry of Food to which it reports remains in the hands of military officers, institutional involvement by the military appears to have lessened. The Arthur D. Little study suggests that Mercal has developed its own transportation capability, either on its own or by contracting. (A leading customs broker has told us that Mercal pays top dollar to obtain trucks to move products from Venezuela's ports and is crowding out other customers.) Also middle and upper management at Mercal has been beefed up by the hiring of

professionals who had formerly worked for private supermarket chains.

17. (C) Cuban involvement with Mercal remains intense. An Arthur D. Little consultant attended an event mounted by

Mercal for potential suppliers. A Cuban, whom he subsequently identified as a Vice Minister of Commerce, had a major role in the event, and appeared to be working with Mercal full-time. She showed impressive knowledge of the Venezuelan food system, including the different food preferences (types of bread, etc.) which customers in distinct regions of the country have. The Cuban presence in the Mercal organization has been confirmed to us by other private sector contacts. The director of government affairs for Cargill (himself a Cuban-Venezuelan) told us that when he had visited Mercal's headquarters, he heard several individuals with strong Cuban accents. Upon being told of his presence, they left the room.

Private Sector Stung Badly, Trying to Come Back

18. (C) Mercal's nearly unbeatable prices have taken their toll at the stores that have traditionally sought to sell to the lower end of the income spectrum. Exactly how much of the Venezuelan retail food market has been taken over by Mercal is hard to determine. In specific areas, such as cooking oil, we have heard figures of up to 30 pct. Arthur D. Little cited a Mercal assertion that it supplied 62 pct of Venezuela's two lowest income categories. As they together make up 81 pct of Venezuela's population, according to a leading market research organization, this would have Mercal supplying 50 pct of the population, a figure which seems exaggerated. Nonetheless, Mercal's penetration has been high. The hardest hit have been the small, family-owned corner stores which have traditionally supplied low income Venezuelans. (These stores, which had enjoyed high mark-ups, were especially vulnerable to the rise of Mercal.) As a result, sales are down at Caracas's big wholesale markets, Quinta Crespo and El Cementerio, which supply these stores.

19. (C) While upscale supermarket chains, such as Excelsior Gama (where the Embassy community largely shops) have been unaffected by the rise of Mercal, older, smaller chains such as Centro Madeirense and Unicasa, which reach down into the lower middle income buyers (classes C and D) have begun to feel the heat. (One marketing consultant with whom econcouns spoke said that he saw a distinct effort on the part of these stores to improve their service and appearance, since they cannot compete on price.) Mercal, of course, has another advantage over its competition. The progressive impoverishment of Venezuela under Chavez has increased the ranks of lower income Venezuelans, for whom price alone must be the only determinant in shopping patterns. There are some efforts by food retailers to fight back. A new chain, "Que Precios!" (What Prices!), is seeking to match Mercal's deep discounting. Food and beverage producer Polar is making a new push to place its products in stores in the slums, using small trucks and sales personnel who will work with store owners to upgrade their selection.

Moving Upstream

110. (C) For food wholesalers, as the President of agri-business giant Cargill's operations in Venezuela told us, "you have to be into Mercal," given the scale of its presence in the market. After the disorganization of its start-up period, Mercal (and by extension wholesale purchaser CASA) has proven to be a reliable customer, paying rapidly for goods. But, as the Arthur D. Little study notes, the Bolivarian state is not likely to be content to be a marketer of private sector-produced goods, but appears interested to move into production itself. The GOV is setting up the "Ezequial Zamora" sugar refining complex (using Brazilian technology, purchased through Cuba, we are told by an industry source). Comments by GOV officials indicate that they see this as the heart of a larger plan to get the state into the food processing business) producing flour and pasta, and other such staples, all to be fed into the Mercal

retail network.

Comment

11. (C) The Mercal chain shows that Chavez's "beautiful revolution" is indeed capable of producing mechanisms which can implement its goals. Both the Arthur D. Little consultants and our own industry contacts agree that Mercal has become a functioning food distribution system that gets products onto the shelves where consumers can get them. Mercal is not efficient by private sector terms) indeed it is designed to provide commodities at subsidized prices, which means that it is able to grab market share through unfair competition. And, we suspect that even as an income support system for poor Venezuelans a less cumbersome system

could have been devised which did not require the GOV to become the nation's grocer) the U.S. food stamp program, which works with the private sector, comes to mind.

12. (C) But as a system for building political support, it has proven its worth. Every customer who buys a discount bag of powdered milk can feel he is getting a tangible benefit from Chavez's government. And, from the point of view of the GOV's broader ideological priorities, it gets the state back into a "strategic" area of the economy, which cannot be left to the politically unreliable private sector, and this in turn becomes a wedge for increasing the state presence further up the chain of production. Of course, the Mercal system's great prices depends on the availability of petroleum revenue to pay for the subsidy) potentially a big problem for Chavez, but with prices high right now, one for another day.
McFarland

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